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<u>VIA HAND DELIVERY</u>

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Rep. Dingell:

The National Rural Electric Cooperative Association (NRECA) appreciates the opportunity to respond to the questions outlined in your April 10 letter. As the trade association representing close to 1000 rural electric cooperatives (RECs) providing electric service to approximately 30 million consumer-owners in 46 states, NRECA has a vital stake in the outcome of the electric restructuring debate. NRECA's answers to your questions are set out below.

1. **What are your biggest concerns about retail competition? If retail competition has been adopted by the state(s) you serve, or is under active consideration, what position have you taken and why?**

   NRECA's members are very concerned that residential, farm, inner city, low income and small business consumers of electric service will not benefit from retail competition to the same extent as large industrial and commercial consumers, and that they may in fact end up with higher bills and less reliable service. NRECA's members have seen the effect of the federal deregulation of other industries (airlines, banking, trucking and railroad, for example) on rural areas, and this only increases their concerns.

   At NRECA's 1997 Annual Meeting held this March, NRECA's members passed a resolution on "Retail Wheeling/Stranded Investment" (copy enclosed as Attachment A). This resolution sets out NRECA's concerns with "cherry picking" of lucrative loads, cost shifting to less desirable customers, stranded cost incurrence and negative impacts on reliability and long-term system planning. NRECA's members in this resolution instruct NRECA staff to examine all federal legislative restructuring initiatives, and to oppose such initiatives unless they meet the following tests:

   A. All classes of customers must be treated equitably.

B. Stranded costs must be borne by those who cause them to be incurred.

C. All energy providers--not just utilities--must be subject to the same standards.

D. All consumers must have universal access to electric service.

E. Safety and reliability must not be jeopardized.

F. Exclusive distribution service areas must be maintained (to prevent duplicative distribution "wires," which are undesirable from a land use, environmental, and cost recovery standpoint).

G. The financial security insured by the all-requirements contract must be protected. (This refers to the long term power supply contracts between generation and transmission (G&T) cooperatives and their member distribution cooperatives, which support the current financing of G&T cooperatives by the federal Rural Utilities Service and private lenders.)

NRECA believes that retail competition decisions should be left, at least for the time being, to each affected state. Different states and regions face markedly different power supply situations. Some states (California, Massachusetts, and New Hampshire, for example) have relatively high power costs and/or troubled utilities, and are moving quickly to implement retail competition. Other regions (the Pacific Northwest, Midwest, and South) enjoy lower cost power and generally good electric service. Some states in these regions are concerned that federally mandated retail competition could actually increase the cost of power to their residents. Still other states (Montana and Oklahoma, for example) do not face high power costs, but are moving to restructure their retail electric industries nonetheless. They are doing so in part because they fear that if they do not, the federal government will impose a federal retail access plan on them that might not work well for their particular state.

NRECA generally does not take positions on state-level restructuring initiatives. It leaves these matters to its individual members and to their state-wide cooperative organizations. Certain states moving to implement retail competition (California and Massachusetts, for example) have few or no RECs, and therefore cooperatives have not been deeply involved in their restructuring efforts. In states with a substantial REC presence, the RECs' positions have depended on their particular circumstances, and whether their own members favor or oppose retail competition. In Pennsylvania, Montana, and Oklahoma, for example, cooperatives have been active participants in crafting restructuring legislation. But in states such as Colorado and Wisconsin, RECs have opposed retail competition initiatives, because they do not believe those specific initiatives would benefit their members. Thus, there is no one "cooperative position" on retail competition, but a variety of approaches in different states.

2. Do you believe Congress should enact legislation mandating retail competition by a date certain, and why or why not?

NRECA does not believe that Congress should at this time enact legislation mandating retail competition by a date certain. As noted above, the circumstances in different states and regions vary substantially, making a "one size fits all" federal mandate unworkable. There are substantial, legitimate concerns about the effect of restructuring on the cost and reliability of electric service, and states should have the time necessary to address these concerns.

3. Some privately owned utilities assert that rural cooperatives enjoy tax-related and other advantages which independently [investor] owned utilities do not, and that these would unfairly benefit cooperatives in a competitive retail marketplace. Do you agree? Do IOU's enjoy any benefits rural cooperatives do not?

RECs do not operate as for-profit entities, diverting profits from operations to pay dividends to a separate class of shareholders, as IOUs do. RECs are organized as not-for-profit, member-owned cooperatives. RECs' lenders require them to charge electricity rates somewhat in excess of operating costs, to provide adequate financial reserves. Any dollars collected over costs are credited to a capital account in each member-owner's name. These dollars are then paid out in cash to each member as the cooperative's finances permit over time. Until the time that these dollars are paid out, each member's contributed capital allows the cooperative to charge its members lower rates. <u>It is the choice of each REC to operate on a member-owned, not-for-profit basis, just as it is the choice of each IOU to operate on a shareholder-owned, for-profit basis.</u>

As not-for-profit entities, most RECs are exempt from the payment of federal income taxes under Section 501(c)(12) of the Internal Revenue Code, so long as at least 85% of their annual income is derived from members. Some RECs (chiefly larger generation and transmission cooperatives that make substantial sales of power to non-members) have chosen to become taxable, but even they operate on a not-for-profit basis in transactions with their members. All RECs pay substantial state and local taxes.

Most G&T and distribution RECs borrow money from the Rural Utilities Service (RUS) to help finance their ongoing operations, including renewal and replacement of transmission and distribution lines. These cooperatives currently have $11.7 billion in loans outstanding from the RUS. They paid $515 million in interest to the U.S. Treasury last year. Since these loans carry an interest rate somewhat lower than that available from private sources, these loans "cost" the U.S. Treasury $286 million annually. RECs also borrow from private sources. In the last five years, only 23% of the annual borrowing of RECs on average has been from the RUS.

RECs provide electric service in many of the least densely populated areas of the country, often over rugged or difficult terrain. In many cases, these areas did not even have electric service until RECs were organized and started up with government assistance, because IOUs refused to provide service in these low-density, high-cost (and hence unprofitable) areas. Even today, RECs serve an average of 6 consumers per mile of line, as contrasted with 35 customers per mile of line for IOUs, and 48 customers per mile of line for municipal utilities. Because of this low customer density and the correspondingly higher costs of providing service--even with the alleged financial advantages RECs enjoy and their non-profit operation--their rates are often higher than those of neighboring utilities. These inherent cost disadvantages will not be eliminated by retail competition.

IOUs, however, receive federal tax assistance that literally dwarfs the modest federal assistance extended to RECs. Because of the intricacies of federal tax law and ratemaking policy, IOUs are permitted to collect in their rates dollars earmarked for the payment of federal income taxes, dollars which in fact they will not remit to the U.S. Treasury for many years to come. The result is that the IOUs effectively hold these monies collected from ratepayers as <u>interest free loans</u> from the U.S. Treasury. NRECA estimates that at the present time, IOUs hold at least <u>$73.8 billion</u> in such loans and other tax subsidies, at an annual cost to taxpayers of <u>$5 billion</u>. The collection and retention of these dollars and the benefits IOUs obtain from them have been documented by the U.S. Treasury, the Congressional Research Service, the National Association of Regulatory Utility Commissioners, and the General Accounting Office. NRECA calculates that federal assistance to IOUs amounts to $57.18 per IOU customer; federal assistance to RECs amounts to $24.76 per REC customer.

NRECA believes that IOUs are unleashing a well-orchestrated campaign on Capitol HIll against RECs, including repeated allegations of "unlevel playing fields" and "subsidies," for three reasons. <u>First</u>, IOUs are attempting to eliminate all possible competitors before retail competition is fully implemented. Cooperatives are attractive suppliers to many retail consumers because of their not-for-profit nature and ownership opportunities, and are thus a natural target for such attacks. (In much the same way, the nation's for-profit banks are mounting a large-scale campaign to eliminate consumer-owned, not-for-profit credit unions.)

<u>Second</u>, IOUs are on the warpath against public power entities to divert attention from their own activities. IOUs already make 78% of all retail electric sales to consumers (with RECs making 8% and municipalities the remaining 14%). They enjoy substantial dominance in generation and transmission markets in many regions of the country. To maintain and enhance their own market power in the face of increasing competition for

their retail markets, IOUs are merging with each other and absorbing other entities (natural gas utilities, independent power producers) at an alarming rate. In 1994-April 1997, at least 27 mergers were announced or completed (see table enclosed as Attachment B).

While the Federal Energy Regulatory Commission (FERC) issued new merger evaluation guidelines in December 1996, it appears to be caving in to IOU pressure to expedite approval of IOU proposed mergers. NRECA believes that if this merger and consolidation trend continues unabated, IOUs will cement their already substantial control over regional generation and transmission markets, to the detriment of consumers. The parallel IOU campaign to repeal the Public Utility Holding Company Act, one of the few electric utility consumer protection statutes on the books, is further evidence of this strategy.

Third, the current disagreement in the ranks of the IOUs on restructuring issues is well-known. The one thing they can all agree upon is to attack "public power." Simply because the IOUs have made such allegations, however, does not make them true. In NRECA's view, a "level playing field" will not be achieved until consumers in rural and other high-cost service areas have electric service and rates fully comparable to those provided to their neighbors in lower-cost areas.

4. **If Congress were to mandate retail competition, please provide any recommendations you have with respect to the following issues.**

   a. ***Stranded investment:*** **How should IOU's stranded investment be treated? Does your cooperative face anything similar and, if so, how should it be treated?**

Some IOUs are low-cost providers and do not anticipate incurring stranded costs due to retail competition. Other IOUs are higher-cost providers, and have substantial stranded cost exposure. Often the difference lies in exactly when an IOU decided to build its generation units, and what type of unit it constructed.

The same is true of RECs. Certain G&T cooperatives have low-cost generation units and power supply contracts, and do not anticipate incurring stranded costs due to retail competition. Other G&Ts, however, have generation facilities and power supply agreements which produce power at rates above the anticipated future market rate for power, and thus face potential stranded costs. Many of these G&T generation investments were made with the full knowledge and assent (and in some cases, the active encouragement) of the federal government, which provided necessary investment funds through the Rural Electrification Administration (REA, now RUS). A significant factor contributing to many RECs' choice of generation investment was the federal Powerplant and Industrial Fuel Use Act of 1978, which: (1) generally prohibited electric utilities from building new generation units which burned natural gas; and (2) required electric utilities to phase out the use of natural gas in existing generation units. Natural gas is now one of the competitive "fuels of choice" for new, lower-priced generation.

NRECA's resolution (attached) says that those customers who cause stranded costs to be incurred should pay them. This means, for example, that if an industrial customer of a distribution cooperative ceases to purchase power from that distribution cooperative, it should pay any costs that would be stranded as a result of its cessation of purchases. Assuming that the distribution cooperative has an "all requirements" power supply contract with a G&T cooperative (which most distribution cooperatives now do), the negative cost recovery impact on the G&T cooperative must be considered as well. This is because it is generally the G&T that invests in the generation and/or power supply arrangements necessary to meet the power supply needs of the distribution cooperative and its retail customers. If this "look-through" to the G&T were not done, then the G&T might not be able to collect sufficient revenue to recover its own costs, and it might be forced to default on its loans, including any loans held by the RUS.

NRECA believes that any monies IOUs collect for stranded cost recovery should in fact be applied to alleviate their stranded cost burden. NRECA is concerned that under some state restructuring plans, IOUs actually stand to improve their financial condition, as a result of overly-generous stranded cost recovery provisions. IOUs should not be permitted to profit from stranded cost recovery programs, or to use stranded cost dollars to finance the purchase of other domestic or overseas utilities. Such a result would only exacerbate the market power problems discussed above.

b. *Reciprocity:* Should Congress consider provisions barring access to markets in states which have adopted retail competition by generators in states which have not? Which interests would this affect, and how?

Reciprocity has not to date been an insurmountable impediment to states moving forward with retail access. If a state believes strongly that reciprocity is required, it can include such a provision in its restructuring plan. Unless and until a court of final authority finds that such a provision conflicts with the U.S. Constitution, NRECA does not think Congress needs to consider intervening with legislation. Such provisions, if included in a state restructuring plan, could favor in-state generation and power suppliers over out-of-state suppliers, and reduce the number of competitors in a state's retail market.

c. ***Local distribution companies (LDC)*: Should Congress require unbundling of LDC services in order to subject them to competition?**

The local distribution functions of distribution RECs are already "subject" to competition. A distribution REC's consumer-owners control it, and they can vote to sell the REC or to unbundle its distribution functions, as they believe to be in their own best economic interests. NRECA therefore does not support federal legislation mandating consumer-owned distribution RECs to unbundle such services as metering, billing, etc., to benefit consumers. On the other hand, a federal mandate requiring consumer-owned distribution cooperatives to unbundle these functions will surely complicate the business operations of many small distribution RECs. They can ill-afford to spend the substantial dollars on duplicative staff, computer systems and other facilities that would be required to unbundle, simply to comply with yet another burdensome federal statutory requirement.

Virtually all of NRECA's distribution cooperative members are "small entities" as that term is used in the Regulatory Flexibility Act (RFA), 5 U.S.C. Sections 601, et seq. NRECA opposes burdening small distribution RECs with additional federal requirements, to benefit "consumers" who already own their RECs, and who have the power to unbundle REC distribution operations if they so desire.

NRECA very much appreciates the opportunity to respond to your questions. I have also enclosed certain additional materials which you may find of interest. If you need more information or have follow-up questions, please feel free to contact me.

Very Truly Yours,

Glenn English
Chief Executive Officer

Enclosures